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Nos. 00-511, 00-555, 00-587, 00-590 and 00-602

# In the Supreme Court of the United States

VERIZON COMMUNICATIONS, INC., ET AL., PETITIONERS

*v.*

FEDERAL COMMUNICATIONS COMMISSION, ET AL.

AND RELATED CASES

*ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT*

## REPLY BRIEF FOR PETITIONERS UNITED STATES AND THE FEDERAL COMMUNICATIONS COMMISSION

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**REPLY BRIEF FOR PETITIONERS UNITED STATES AND THE FEDERAL COMMUNICATIONS COMMISSION**

## I. THE FCC'S CHOICE OF TELRIC TO DETERMINE THE "COST" OF NETWORK ELEMENTS IS ENTITLED TO *CHEVRON* DEFERENCE

### A. The FCC's adoption of a methodology based on the forward-looking cost of providing a given element, using the most efficient available technology, is consistent with the text and purpose of the 1996 Act

The "general terms" that Congress employed in 47 U.S.C. 252(d)(1) to articulate the pricing standard for network elements—"just and reasonable" rates "based on * * * cost" —"give ratesetting commissions broad methodological lee-

way" and "say little about the 'method employed' to determine a particular rate." *AT&T* v. *Iowa Utils. Bd.* (*Iowa Utils. Bd. I*), 525 U.S. 366, 423 (1999) (Breyer, J., concurring in part and dissenting in part). In view of the flexibility inherent in the statutory language, the competitive purposes of the 1996 Act, and the contemporaneous use of similar forward-looking methodologies by other regulators, the Eighth Circuit erred in holding that the "plain language" of Section 252(d)(1) foreclosed the choice of TELRIC to set network element rates. See U.S. Pet. Br. 21-31; U.S. Resp. Br. 16-26.

The incumbent local exchange carriers contend that TELRIC is inconsistent with 47 U.S.C. 252(d)(1), which states that rates for network elements be "based on the cost * * * of providing the * * * network element." They argue that the statutory text, if it permits the adoption of *any* forward-looking methodology at all, requires the adoption of a methodology based on what they characterize as "actual" forward-looking costs. See Br. for Respondents BellSouth *et al.* (BellSouth Resp. Br.) 14-15. They do not define that concept, but they appear to suggest that the Act requires that network element prices be tied to the prices of their existing facilities. Nothing in the statutory text, however, requires the FCC to adopt a ratemaking methodology that is constrained in that fashion. The Act requires compensation for the "cost * * * of *providing*," 47 U.S.C. 252(d)(1) (emphasis added), the "features, functions and capabilities" that constitute network elements, 47 U.S.C. 153(29). The text permits the FCC to choose a methodology, such as TELRIC, that is based on the forward-looking costs of providing those "features, functions, and capabilities" using the most efficient technology available on the market. Those are the costs that carriers in competitive markets would *actually* consider in making decisions concerning entry, pricing, and investment.

The incumbents also contend that the Eighth Circuit's construction of the network element pricing standard is mandated by other provisions of the 1996 Act—the same provisions that the incumbents elsewhere invoke as mandating a contrary construction of the network element pricing standard based on historical costs. Compare Verizon Pet. Br. 19-23, with BellSouth Resp. Br. 14-16. We have explained why those provisions evince no intent by Congress to restrict the FCC to any particular pricing methodology. See U.S. Resp. Br. 22-26.[1]

**B. The FCC's choice of a methodology based on the forward-looking cost of providing a given element, using the most efficient available technology, is reasonable**

The incumbents principally argue not that TELRIC is contrary to the text of the 1996 Act and thus fails the first step of *Chevron U.S.A. Inc.* v. *NRDC*, 467 U.S. 837, 842-843 (1984), but that TELRIC is based on unreasonable economic assumptions and thus fails the second step of *Chevron*. "[N]either law nor economics," however, "has yet devised generally accepted standards for the evaluation of rate-making orders." *Permian Basin Area Rate Cases*, 390 U.S. 747, 790 (1968). The fact that "some or many economists

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[1] The incumbents contend, for example, that TELRIC is inconsistent with the reference to "a reasonable profit" in 47 U.S.C. 252(d)(1)(B) and with the rate standard in 47 U.S.C. 252(d)(3) for services purchased by new entrants for resale to consumers, which is tied to incumbents' retail rates. TELRIC incorporates the concept of "reasonable profit," however, and thus comports with Congress's provision that network element rates "may include a reasonable profit." See U.S. Resp. Br. 22-23. The purchase of services for resale and the lease of network elements are distinct entry vehicles, and the pricing standards for those entry vehicles are described in different terms in different statutory subsections. There is thus no reason to conclude that Congress meant the two standards to be identically tied to incumbents' existing circumstances. See *id.* at 24-26.

would disapprove of the [agency's] approach does not answer the question presented" to a court on review of the agency's rate-making decisions, because courts "do not sit as a panel of referees on a professional economics journal, but as a panel of generalist judges obliged to defer to a reasonable judgment by an agency acting pursuant to congressionally delegated authority." *City of Los Angeles* v. *United States Dep't of Transp.*, 165 F.3d 972, 977 (D.C. Cir. 1999) (Silberman, J.), cert. denied, 528 U.S. 1074 (2000). Such deference is fully warranted here.

1. After careful review of an extensive record, which included economic commentary on all sides of the issue (see *Local Competition Order* (paras. 635-671), J.A. 340-375), the FCC adopted TELRIC, which the FCC viewed as providing the best approximation of an incumbent's forward-looking cost of providing network elements to itself and others, if the incumbent acted rationally in a competitive market. See *Local Competition Order* (paras. 672-679, 685), J.A. 375-380, 383-384. The FCC selected a long-run period for measuring costs in order to "ensure[] that rates recover not only the operating costs that vary in the short run, but also fixed investment costs that, while not variable in the short term, are necessary inputs directly attributable to providing the element." *Local Competition Order* (para. 692), J.A. 387-388.

The FCC recognized that an economically rational carrier can be expected, over the long run, to construct a network with "the most efficient network architecture, sizing, technology, and operating decisions that are operationally feasible and currently available to the industry." *Local Competition Order* (para. 683), J.A. 382-383. But the FCC did not fully incorporate that expectation into TELRIC. The FCC instead decided that TELRIC should take as given the "existing network design" so that "wire centers will be placed at the incumbent LEC's current wire center locations"—*i.e.*, switches will continue to be deployed at

existing locations, and loops and transport trunks will continue to terminate at those locations. See *Local Competition Order* (para. 685), J.A. 383-384; see also 47 C.F.R. 51.505(b)(1). The FCC concluded that such a hybrid of "existing" and "most efficient" design would serve multiple purposes: It would mitigate incumbents' concerns that TELRIC would not reflect the additional costs attributable to past decisions regarding the most fundamental aspects of their existing networks; it would encourage new entrants to design and build networks of their own, to the extent that they could thereby operate more efficiently than they could by leasing elements of incumbents' networks; and it would enable state public utility commissions to implement TELRIC more expeditiously based on existing models that typically incorporated a wire-center limitation. See *Local Competition Order* (para. 685), J.A. 383-384.[2]

The FCC might reasonably have omitted the "wire centers" limitation, or it might reasonably have drawn the line somewhere else within the structure of the network. Choosing among such options, however, is a classic exercise in administrative line-drawing, and courts do not generally upset an agency's choice in such matters unless the lines drawn "are patently unreasonable, having no relationship to the underlying regulatory problem." *Cassell* v. *FCC*, 154 F.3d 478, 485 (D.C. Cir. 1998). Here, the FCC drew an entirely reasonable line, balancing the conceptual benefits of a pure forward-looking approach against the practical

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[2] The incumbents thus err in asserting (BellSouth Resp. Br. 18) that "the FCC has simply overlooked the fundamental fact that, in an industry with long-lived capital investment, a carrier is constrained by its existing network." The FCC explicitly took that "fundamental fact" into account in incorporating the "wire centers" limitation into TELRIC, as well as in providing for TELRIC rates to reflect depreciation and the cost of capital (see pp. 10-12, *infra*).

advantages (and administrative convenience) of taking into account the basic architecture of the existing network. The incumbents present no legally sufficient basis for compelling the FCC to draw a different line.

2. The incumbents argue that any reasonable forward-looking methodology would have to be tied to their "actual" forward-looking costs, as opposed to the forward-looking costs of a "hypothetical" carrier. See BellSouth Resp. Br. 11-12, 14. But they do not explain what they mean by "actual" forward-looking costs. By definition, forward-looking costs, in contrast to historical costs recorded in regulatory books of account, do not replicate actual past outlays. They are instead "costs that a carrier would incur in the future." *Local Competition Order* (para. 683), J.A. 382-383.[3] The costs measured by TELRIC are nonetheless those of the incumbent itself. Those costs are based, moreover, on actual prices of equipment that is commercially available today—equipment that carriers are already using to upgrade and expand their networks. See, *e.g.*, *AT&T* v. *FCC*, 220 F.3d 607, 617 (D.C. Cir. 2000) (state commission, in setting TELRIC price for switching element, looked to prices of switches recently purchased by incumbent).

The incumbents appear to be proposing a methodology based on the "actual" cost, in today's market, of duplicating "actual" existing networks in all physical particulars—or, stated differently, the "application of up-to-date prices to

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[3] Any forward-looking cost methodology is necessarily predictive, and thus "hypothetical," to the extent that it must, for example, establish appropriate depreciation rates and costs of capital. See pp. 10-12, *infra*. But the fact that a rate methodology involves predictive judgments does not render it economically untenable. Many aspects of traditional historical cost ratemaking also require such judgments. See U.S. Pet. Br. 30-31; U.S. Resp. Br. 48; see also Public Serv. Comm'n of N.Y. Br. 10-11 (explaining that "ratemaking is essentially a prospective, forward-looking, exercise," whatever the particular methodology applied) (emphasis omitted).

out-of-date properties." James C. Bonbright et al., *Principles of Public Utility Rates* 294 (1988). Economists, including those upon whom the incumbents rely, uniformly agree that such a measurement is "economically meaningless." *Ibid*; accord 1 Alfred E. Kahn, *The Economics of Regulation: Principles & Institutions* 112 (1988); see also *Missouri ex rel. S.W. Bell Tel. Co.* v. *Public Serv. Comm'n*, 262 U.S. 276, 312 (1923) (Brandeis, J., dissenting) (disparaging, as the *least* appropriate cost methodology, an inquiry into "what it would cost to reproduce the identical property"). The FCC considered, but rejected, such an approach as "essentially an embedded [*i.e.*, historical] cost methodology," which would produce "prices for interconnection and unbundled elements that reflect inefficient or obsolete network design and technology." *Local Competition Order* (para. 684), J.A. 383. Such prices would distort a competing carrier's analysis of whether, or how, to enter a local telecommunications market, by encouraging, for example, the carrier to construct inefficient, duplicative facilities. See *Local Competition Order* (paras. 620, 630, 679), J.A. 327-328, 333-334, 379-380.[4]

3. The incumbents assert that TELRIC assumes that a carrier would scrap its existing network and rebuild a new, more efficient one every time an advance in technology occurs. See, *e.g.*, BellSouth Resp. Br. 12, 26-27. TELRIC assumes no such thing.

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[4] Another possible measure of "actual" forward-looking costs would take into account only incumbents' short-run incremental costs. Such a measure finds some support in the Eighth Circuit's decision. See U.S. Pet. App. 9a-10a ("In our view it is the cost to the ILEC of carrying the *extra burden* of the competitor's traffic that Congress entitled the ILEC to recover.") (emphasis added). But that approach would yield rates *lower* than TELRIC in the usual case in which no additional capital investment beyond that which has already been made is needed to provide network elements to a new entrant. It is thus unlikely that the incumbents would support such an alternative.

TELRIC instead rests on the rational economic assumption that, as new, more efficient equipment becomes available, the value of older, less efficient equipment will be affected. To use an example suggested by the incumbents (see BellSouth Resp. Br. 26), if new, more fuel-efficient aircraft were to become available, airlines would not necessarily respond by immediately replacing their older, less fuel-efficient aircraft, which could still have a significant useful life. The relevant point is that the market value of the older aircraft would depend *not* on what the owner originally paid for it, but on the cost of continuing to operate it relative to the cost of acquiring and operating the new equipment. Thus, if an airline were to offer to sell or lease its older aircraft, the price at which it could do so would be constrained by the cost of acquiring and operating the new aircraft. Airlines considering whether, or how, to enter the market would base their decision, in significant part, on that cost.[5] To serve its goals of promoting competition and efficiency in local telecommunication markets while providing fair compensation to incumbents, the FCC similarly required state commissions to use the long-run forward-looking costs of providing network elements using the most efficient technology currently available.[6]

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[5] See, *e.g.*, William J. Baumol & Thomas W. Merrill, *Does the Constitution Require that We Kill the Competitive Goose: Pricing Local Phone Services to Rivals*, 73 N.Y.U. L. Rev. 1122, 1147 (1998) (explaining that the "threat of potential competition" from new entrants with more efficient equipment will cause "even incumbents with outdated high-cost equipment * * * to adjust their prices to efficient costs"). Professors Baumol and Merrill observe that, although an incumbent may not immediately reduce its own prices all the way to forward-looking costs of the more efficient equipment, the incumbent will do so over the relative short term. Compare BellSouth Resp. Br. 16 (faulting the FCC for supposedly assuming that price adjustments would be rapid).

[6] The incumbents complain that the FCC, in adopting TELRIC, is "creat[ing] the *appearance* of competition," not "real competition," which

The question thus is not, as the incumbents suggest, whether it is sometimes prudent for a firm to make do with dated assets even after more efficient alternatives appear on the market. The question, instead, is whether those alternatives may reasonably be taken into account in determining the compensation to which a firm is entitled for the use of those assets. The answer is clearly yes. In the closely analogous circumstances of the government's condemnation of the assets of a private firm (*e.g.*, a printing plant), the owner could not demand compensation above fair market value for its obsolescent assets (*e.g.*, manual "hot type" equipment), even if the owner had acted reasonably in not replacing those assets as soon as more efficient alternatives (*e.g.*, computerized "cold type" equipment) appeared on the market. See generally Herbert Hovenkamp, *The Takings Clause and Improvident Regulatory Bargains*, 108 Yale L.J. 801, 828-830 (1999). TELRIC entitles incumbents to a recovery that approximates fair market value. See U.S. Resp. Br. 35-36.[7]

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the incumbents view as limited to facilities-based competition. BellSouth Resp. Br. 2. But it was Congress, not the FCC, that chose to foster competition in local telecommunications markets in a variety of ways, including by enabling new entrants to lease elements of incumbents' networks. Congress understood, for example, that new entrants could thereby develop the expertise, capital, and customer base that they might need in order to support extensive construction of new facilities. Moreover, contrary to the incumbents' suggestion, new entrants are, in fact, competing in local telecommunications markets by serving customers with their own facilities as well as facilities leased from incumbents. See U.S. Resp. Br. 44-46.

[7] Similarly, TELRIC, contrary to the incumbents' contention (BellSouth Resp. Br. 7), does not assume that an efficient carrier would provide the switching element with large-capacity switches, rather than with a mix of smaller switches and so-called "add-on modules." See *AT&T* v. *FCC*, 220 F.3d at 616-618 (upholding FCC's decision that New York Public Service Commission had not misapplied TELRIC in failing to set switching rates based on discounted prices that ignored growth additions).

4. The incumbents contend that, because the forward-looking costs of some facilities will predictably decrease over their expected lives, TELRIC will preclude a carrier from ever recovering its full forward-looking costs. That argument is incorrect.

In calculating how a carrier may recover the forward-looking costs of particular network elements, TELRIC takes into account not only the direct forward-looking cost of constructing, maintaining, and operating an element, but also the appropriate rate of depreciation, which reflects how quickly a carrier must recover those costs in order to account for the prospects of wear and tear and technological obsolescence. See 47 C.F.R. 51.505(b)(3); *Local Competition Order* (paras. 702-703), J.A. 395-396. TELRIC also takes into account the forward-looking cost of capital and a reasonable allocation of forward-looking common costs. See 47 C.F.R. 51.505(b)(2) and (c).

Virtually all cost methodologies assume that, although a prudent firm would not necessarily replace a facility the moment a more efficient substitute appears on the market, the firm ordinarily would replace that facility at some point. Those methodologies consequently require regulators to determine the useful life of an asset and to provide an opportunity for cost recovery within that period. TELRIC is no different. It thus accommodates reasonable economic assumptions about future technological advances and the effects those advances will have on the value of current assets. Indeed, in the FCC rulemaking that produced

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In addition, the incumbents' suggestion (BellSouth Resp. Br. 7-8) that TELRIC authorizes regulators to require incumbents to modify, "for free," loops to facilitate certain advanced services ignores express FCC directions to the contrary. See *Deployment of Wireline Servs. Offering Advanced Telecomms. Capability*, 14 F.C.C.R. 20,912, 20,954, 20,978-20,979 (1999) (paras. 87, 148), petition for review pending *sub nom. United States Telecom Ass'n* v. *FCC*, No. 00-1012 (D.C. Cir. Jan. 18, 2000).

TELRIC, the incumbents acknowledged that an accurate calculation of economic depreciation and the cost of capital would obviate the problem that they allege here. See Declaration of Alfred E. Kahn & Timothy J. Tardiff 3-4 (Reply Comments of Bell Atl., Ex. 1), *Implementation of the Local Competition Provisions in the Telecomms. Act of 1996*, CC Docket No. 96-98 (FCC filed May 30, 1996).

In the local competition context, the FCC has not prescribed particular depreciation schedules for network elements. The FCC has instead left it to state public utility commissions to determine how best to adopt "specific depreciation rate adjustments that reflect expected asset values over time," including, where relevant, "expected declines in the value of capital goods." *Local Competition Order* (para. 686), J.A. 384-385. Among their many options, state commissions could, where circumstances warrant, adopt accelerated depreciation schedules that provide faster recovery of incumbents' forward-looking costs at the beginning of the relevant period than at the end, or state commissions could choose some other method of ensuring adequate recovery of forward-looking costs. The incumbents provide no basis for questioning the ability of state commissions, in applying TELRIC to particular circumstances, to provide full recovery of incumbents' forward-looking costs.

The incumbents are also incorrect in asserting that TELRIC requires state commissions to retain the depreciation schedules and cost of capital determinations that were set under prior historical-cost ratemaking regimes. See BellSouth Resp. Br. 31-33. Although the FCC stated that existing determinations provide "a reasonable starting point for TELRIC calculations," *Local Competition Order* (para. 702), J.A. 395-396, the FCC was merely offering tentative guidance at a time when state commissions had to make large numbers of ratemaking determinations under the short

time frames established in Section 252. The statement does not alter the governing standard, set forth in the rules, that requires state commissions to determine the true economic depreciation rate and risk-adjusted cost of capital. 47 C.F.R. 51.505(b)(2) and (3). Indeed, the FCC specifically directed state commissions to depart from the previously established depreciation and cost of capital determinations when incumbents show that those determinations do not comply with that standard. *Local Competition Order* (para. 702), J.A. 395-396.[8]

5. The incumbents reassert their arguments that, in order to avoid Takings Clause concerns, the 1996 Act must be construed to foreclose TELRIC. See BellSouth Resp. Br. 36-41. The incumbents are incorrect for reasons previously explained. See U.S. Resp. Br. 26-41. The incumbents make no effort here to substantiate their claim (BellSouth Resp. Br. 36-37) that TELRIC, as applied by state commissions, is producing network element rates that are "noncompensatory" of incumbents' "actual" forward-looking costs (or their costs by any other measure).

The incumbents further contend that the FCC's use of TELRIC to produce rates similar to those that would exist in a competitive market violates constitutional principles and statutory goals where, as here, a competitive market does not yet exist. See BellSouth Resp. Br. 19-20, 38-41; Qwest Br. 18-20. Such arguments disregard that a central objective

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[8] Moreover, an appropriate cost of capital determination takes into account not only existing competitive risks, as the FCC explicitly recognized (see *Local Competition Order* (para. 702), J.A. 395-396), but also risks associated with the regulatory regime to which a firm is subject. That second consideration is, notwithstanding the incumbents' contrary suggestion (BellSouth Resp. Br. 30-32), implicit in any determination of the true economic cost of capital. See generally *Represcribing the Authorized Rate of Return for Interstate Servs. of Local Exch. Carriers*, 5 F.C.C.R. 7507, 7521 (1990) (para. 120), aff'd *sub nom. Illinois Bell Tel. Co.* v. *FCC*, 988 F.2d 1254 (D.C. Cir. 1993).

of rate regulation—one that has particular resonance in connection with the competitive objectives of the 1996 Act—has always been to "restore the 'true' market price—the price that would result through the mechanism of a truly competitive market." *Farmers Union Cent. Exch., Inc.* v. *FERC*, 734 F.2d 1486, 1510 (D.C. Cir.), cert. denied, 469 U.S. 1034 (1984); see *Duquesne Light Co.* v. *Barasch*, 488 U.S. 299, 308 (1989) (replacement cost methodologies are appropriately designed to "mimic[] the operation of the competitive market"). The absence of a competitive market is thus no reason to discard ratemaking methodologies that simulate market prices. It is, rather, a justification for using such methodologies.

The incumbents, citing eminent domain cases, assert that "market value may not be used as the basis for compensation in the absence of an objective standard of comparable and reliable market transactions." BellSouth Resp. Br. 38. Those cases, however, provide simply that traditional methods of determining value on the basis of the prices that sellers of comparable goods or services are commanding do not yield a fair or workable measure of just compensation where no market, or no competitive market, exists. In such circumstances, the market prices may be higher than the Just Compensation Clause requires, making it appropriate to determine compensation on another basis that simulates "fair market value" and not "hold-up value." *United States* v. *Cors*, 337 U.S. 325, 334 (1949). That, of course, is an objective of rate regulation as well.

Similarly, there is no merit to the incumbents' suggestion that it is inconsistent with the 1996 Act's deregulatory objectives to require network elements to be priced at rates that a competitive market would yield. Qwest Br. 18-20. The Act, to be sure, is intended to reduce *unnecessary* regulation in order to promote competition, but the Act also intends for the FCC and the state commissions to continue to engage in

*necessary* regulation, including the enforcement of incumbents' obligations to provide new entrants with interconnection and network elements. Congress did not assume that incumbents would fulfill those obligations without regulatory intervention. See, *e.g.*, 47 U.S.C. 252(b) and (e)(5) (providing for compulsory arbitration of interconnection agreements by state commissions or FCC). And, although Congress authorized the FCC to "forbear" from applying most provisions of the Act if the FCC finds that they are not needed to protect consumers or otherwise to advance statutory goals, 47 U.S.C. 160(a), Congress expressly prohibited the FCC from forbearing with respect to "the requirements of section 251(c) * * * until it determines that those requirements have been fully implemented," 47 U.S.C. 160(d).

In sum, the FCC reasonably found that the statutory requirement that incumbents give new entrants access to their networks at rates "based on the cost of providing the * * * network element," 47 U.S.C. 252(d)(1)(A)(i), is most sensibly implemented by setting rates based on the long-run forward-looking costs of efficient, currently available technology. It is those costs that are relevant to decisions regarding pricing, entry, and investment in competitive markets. *Local Competition Order* (paras. 620, 630, 679, 740), J.A. 327-328, 333-334, 379-380, 422-423; see *MCI Communications Corp.* v. *AT&T*, 708 F.2d 1081, 1116-1117 (7th Cir.) ("[I]t is current and anticipated cost, rather than historical cost, that is relevant to business decisions to enter markets."), cert. denied, 464 U.S. 891 (1983). TELRIC is designed to compensate incumbents for their full forward-looking costs of providing network elements; to enable competitors efficiently to enter the market and to acquire expertise, capital, and a customer base, while providing incentives for them to construct their own facilities where doing so makes economic sense; and ultimately to afford consumers the benefits of retail rates that reflect com-

petitive market pricing. *Local Competition Order* (paras. 307, 620, 679, 682-688), J.A. 299-300, 327-328, 379-380, 381-386; see *Implementation of the Local Competition Provisions in the Telecomms. Act of 1996* (*UNE Remand Order*), 15 F.C.C.R. 3696, 3701, 3749 (1999) (paras 7, 112), petitions for review pending *sub nom. United States Telecom Ass'n* v. *FCC*, No. 00-1015 (D.C. Cir. Jan. 19, 2000). The FCC's decision to adopt TELRIC was a reasonable policy choice on a matter that Congress left to the expert agency to resolve. See *Chevron*, 467 U.S. at 842-845.

## II. THE FCC'S COMBINATIONS RULES ARE ENTITLED TO *CHEVRON* DEFERENCE

### A. The challenge to the Eighth Circuit's invalidation of Rules 315(c)-(f) has not been waived

The incumbents renew their argument, which they raised at the petition stage, that petitioners "abandoned" or "waived" any challenge to the Eighth Circuit's invalidation of the combinations rules, 47 C.F.R. 51.315(c)-(f), by not raising such a challenge in *Iowa Utilities Board I*. See BellSouth Resp. Br. 41-43. This Court, however, granted certiorari in these consolidated cases to review the Eighth Circuit's holding with respect to Rules 315(c)-(f), notwithstanding the incumbents' argument that the question had not been properly preserved.

Nor did the Eighth Circuit treat its decision in *Iowa Utilities Board I* as precluding its reconsideration of the validity of Rules 315(c)-(f). On remand from this Court's decision, the Eighth Circuit ordered briefing on whether, "in light of the Supreme Court's decision, this court should take any further action with respect to * * * § 51.315(c)-(f) (unbundling rules)." Order at 2-3 (June 10, 1999) (No. 96-3321 & consolidated cases). Subsequently, the Eighth Circuit, without invoking the doctrine of waiver, issued a new decision invalidating Rules 315(c)-(f) on the merits, albeit for

the same reasons stated in *Iowa Utilities Board I*. See U.S. Pet. App. 26a-29a. No authority precludes the Court from reviewing that decision at this time. Indeed, the question has taken on added significance since *Iowa Utilities Board I*, given the circuit conflict that has arisen as to whether Section 251(c)(3) precludes the adoption of such combinations requirements. See U.S. Pet. 27-28.[9]

### B. Rules 315(c)-(f) are the product of an expert agency's reasonable construction of ambiguous statutory language

Rules 315(c)-(f) require incumbents to combine elements that are currently not combined in their networks, if a new entrant requests the combination and compensates the incumbent for providing it. The Eighth Circuit held that those Rules "violate the plain language" of 47 U.S.C. 251(c)(3), which it construed as requiring new entrants, rather than incumbents, to combine such elements. That view is mistaken. Section 251(c)(3), which states that "[a]n incumbent local exchange carrier shall provide such unbundled network elements in a manner that allows requesting carriers to combine such elements," is ambiguous as to

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[9] The incumbents' reliance (BellSouth Resp. Br. 42-43) upon *Communist Party* v. *Subversive Activities Control Board*, 367 U.S. 1 (1961), is misplaced. In that case, the Court held that, in challenging agency orders, private parties may not "withhold in this Court and save for a later stage procedural error" that could "make waste" more than "ten years of litigation;" the Court explained that permitting such tactics would lead to unnecessary "expenditures of agency time" on remand and would "foist upon the Court constitutional decisions which could have been avoided had those errors been invoked earlier." *Id.* at 31-32 & n.8. No similar circumstance exists here. The government itself has sought review of the decision at issue, so any concern about "expenditures of agency time" is absent; the claim presented is not a procedural issue antecedent to a constitutional issue that the Court might have sought to avoid; and the lower courts now have split on the consequences of this Court's previous decision, such that the need for the Court's intervention is now obvious.

whether incumbents may be required to combine elements. The FCC reasonably resolved the question by requiring incumbents to combine elements in circumstances where they can do so more efficiently than new entrants, *i.e.*, where the new entrant, rather than combining the elements itself, elects to compensate the incumbent for doing so.

1. The incumbents, in seeking to defend the Eighth Circuit's holding that Rules 315(c)-(f) are invalid under step one of the *Chevron* analysis, argue that Section 251(c)(3) "envision[s] that competitors, not incumbents, would be responsible for combining elements for their own use." BellSouth Resp. Br. 44. The incumbents read too much into the statutory text.

Section 251(c)(3) does, to be sure, give new entrants the right to combine unbundled elements in an incumbent's network. But nothing in Section 251(c)(3) gives incumbents the right to refuse to combine such elements, even when the new entrant will pay the incumbent to have the elements provided in combined, rather than unbundled, form. As the FCC recognized, "[t]he phrase 'allows requesting carriers to combine them' [in Section 251(c)(3)] does not impose the obligation of physically combining elements exclusively on requesting carriers," but instead allows that obligation to be imposed on either new entrants or incumbents, or both. *Local Competition Order* (para. 294), J.A. 296-297.

The FCC's reading of Section 251(c) is consistent with this Court's reading of that same provision in *Iowa Utilities Board I*. There, the Court rejected a similar "plain language" challenge to Rule 315(b), 47 C.F.R. 51.315(b), which prohibits an incumbent from disconnecting already combined elements if the new entrant requests the elements in combined form. The Court explained that Section 251(c)(3) "does not say, or even remotely imply, that elements *must*

[never] be provided [by incumbents] * * * in combined form." 525 U.S. at 394.[10]

2. The incumbents attempt to distinguish this Court's earlier decision on the ground that Rule 315(b) was designed to prevent "sabotage" by incumbents and thus serves the requirement of Section 251(c)(3) that access to network elements be provided on "just, reasonable, and nondiscriminatory" terms. See BellSouth Resp. Br. 44. That argument has no bearing on whether the plain language of Section 251(c)(3) forecloses the FCC from requiring incumbents to combine elements in their networks. Moreover, Rules 315(c)-(f), like Rule 315(b), reasonably advance Congress's purpose of assuring "just, reasonable, and nondiscriminatory" access to network elements, because they prevent incumbents from erecting barriers to new entrants' use of network element combinations that incumbents themselves would not encounter. See U.S. Pet. Br. 40-42. Indeed, the FCC justified Rules 315(c)-(f) as necessary to prevent new entrants from being "seriously and *unfairly* inhibited in

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[10] The incumbents assert that the FCC "previously stated unequivocally that [Rules 315(c)-(f)] do not present the same question that the Court addressed in *Iowa Utilities Board*" with respect to Rule 315(b). BellSouth Resp. Br. 45. That assertion, while of no particular significance to the merits here, warrants clarification. After the Eighth Circuit's 1997 decision in *Iowa Utilities Board I* invalidating Rules 315(c)-(f), the FCC opposed rehearing petitions that sought to extend that decision to Rule 315(b). The FCC argued that "the [Eighth Circuit's] rationale" for invalidating Rules 315(c)-(f) did not require the invalidation of Rule 315(b). Response of Federal Respondents to Petitions for Rehearing at 9 (Oct. 1, 1997) (No. 96-3321 & consolidated cases). The Eighth Circuit disagreed and invalidated Rule 315(b) on rehearing. This Court reversed. We have since consistently maintained that *this Court's* rationale in *Iowa Utilities Board I* for upholding Rule 315(b) also supports upholding Rules 315(c)-(f). See, *e.g.*, *UNE Remand Order*, 15 F.C.C.R. at 3909 (para. 481) ("As a general matter, however, we believe that the reasoning of the Supreme Court's decision to reinstate rule 51.315(b) based on the nondiscrimination language of section 251(c)(3) applies equally to rules 51.315(c)-(f).").

their ability to use unbundled elements to enter local markets." *Local Competition Order* (para. 293), J.A. 295-296 (emphasis added). Thus, although, as the incumbents note (BellSouth Resp. Br. 46), the FCC did not "cite Section 251(c)(3)'s nondiscrimination ban in the relevant portions of its *Order*," the FCC's justification for Rules 315(c)-(f), in those very portions of the *Order*, demonstrates the FCC's concern with protecting against "unfair" practices of incumbents against new entrants.[11]

The incumbents claim that it is not discriminatory for an incumbent to force a new entrant to use its own workforce and its own resources to combine elements in the incumbent's network. See BellSouth Resp. Br. 45. The FCC, however, reasonably concluded otherwise. The FCC recognized that a new entrant is not "on an equal footing" (*ibid.*) with an incumbent in such circumstances, because the new entrant may often lack the "facilities and information about the incumbent's network" to perform the combinations as efficiently as the incumbent, if at all. *Local Competition Order* (para. 293), J.A. 295-296; see also U.S. Pet. Br. 42-44 (discussing incumbents' practices since the invalidation of Rules 315(c)-(f) that impede new entrants' ability to combine network elements).

3. The incumbents further contend that the FCC, in the *Local Competition Order*, offered the same justification for Rules 315(c)-(f) as it did for other rules that have been invalidated by this Court or the Eighth Circuit. For example, the incumbents argue that the FCC "required blanket access to network elements on the theory that Section

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[11] The incumbents are thus mistaken in suggesting (see BellSouth Resp. Br. 46 and n.37) that the FCC is now seeking to justify Rules 315(c)-(f) on grounds different from those advanced in its *Local Competition Order*. See *UNE Remand Order*, 15 F.C.C.R. at 3909 (para. 481) (reflecting FCC's understanding that Rules 315(c)-(f) are grounded in "the nondiscrimination language of section 251(c)(3)").

251(c)(3) impose[s] on an incumbent LEC the duty to provide all network elements for which it is technically feasible to provide access," that the FCC offered the same theory to justify Rules 315(c)-(f), and that the Court rejected that theory in invalidating Rule 319, 57 C.F.R. 51.319, in *Iowa Utilities Board I*. See BellSouth Resp. Br. 46. The incumbents' argument rests on an erroneous premise. The FCC did *not* offer the same rationale for Rules 315(c)-(f) as for Rule 319; rather, as explained, the FCC adopted Rules 315(c)-(f) to assure that network elements are available to incumbents on "just, reasonable, and nondiscriminatory" terms, 47 U.S.C. 251(c)(3). That the Court invalidated a different rule, which addressed a different subject and rested on a different rationale, provides no basis for invalidating Rules 315(c)-(f).[12]

For the foregoing reasons and those stated in our opening brief, the judgment of the court of appeals should be reversed insofar as it vacated 47 C.F.R. 51.505(b)(1) and 47 C.F.R. 51.315(c)-(f).

Respectfully submitted.

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JULY 2001

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[12] Similarly, the incumbents claim (BellSouth Resp. Br. 46-47) that Rules 315(c)-(f) are "a species of superior-quality regulation," which the Eighth Circuit has invalidated and which are not at issue here. Again, the FCC's rules regarding the quality of network elements that incumbents must provide, set forth in Rule 311(c), 47 C.F.R. 51.311(c), are distinct from Rules 315(c)-(f), which address who may be required to combine network elements.